United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

ORIGINAL

74-1893

United States Court of Appeals

FOR THE SECOND CIRCUIT

B P/S

GEORGE FELDMAN, as Trustee in Bankruptcy of LEASING CONSULTANTS, INCORPORATED, Bankrupt,

Plaintiff-Appellee,

against

FIRST NATIONAL CITY BANK,

Defendant-Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF DEFENDANT-APPELLANT FIRST NATIONAL CITY BANK

ZALKIN, RODIN & GOODMAN
Attorneys for Defendant-Appellant First National City Bank
750 Third Avenue
New York, New York 10017
(212) 682-6900

HENRY LEWIS GOODMAN
Of Counsel

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Statement

Defendant-Appellant First National City Bank ("Citibank") appeals from a judgment of the Southern District (Bauman, D.J.) dated June 11, 1974, as amended and corrected nunc pro tunc on June 26, 1974, granting Plaintiff-Appellee George Feldman, as Trustee in Bankruptcy of Leasing Consultants Incorporated, Bankrupt (the "Trustee"), summary judgment with respect to the First, Second and Third Causes of Action contained in the Trustee's complaint (A 99-105).*

According to the complaint, the jurisdiction of this Court was based upon the Federal Aviation Act of 1958 ("FAA")

* References are to pages of the Joint Appendix herein.

49 U.S.C. § 1301, et seq., Section 70 of the Bankruptcy Act (11 U.S.C. § 110) and 12 U.S.C. § 94 (A 4-5).

Each of the three causes of action sought to invalidate an assignment of an aircraft lease by the Bankrupt to Citibank upon the ground that neither the lease relating to the particular aircraft between the Bankrupt as lessor and the lessee, nor the assignment of the lease by the Bankrupt to Citibank, were recorded with the Administrator of the Federal Aviation Administration (A 5-10). The Trustee sought and was granted a summary judgment directing Citibank to turn over to him all payments received by it under each of the three aircraft leases, subsequent to August 18, 1970, the date the Bankrupt filed a petition under Chapter XI of the Bankruptcy Act, together with interest thereon (A 4, 10-11).

Following the filing of the complaint herein on April 18, 1973 (A 2), Citibank moved in advance of answer for an order dismissing all of the causes of action contained in the complaint, pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure ("FRCP"), upon the ground that each of the causes of action failed to state a claim upon which relief could be granted: that each of the four causes of action were time-barred by Section 11(e) of the Bankruptcy Act (11 U.S.C. § 29(d)) in that the action was not instituted by the Trustee within two years subsequent to the date of adjudication in bankruptcy of the Bankrupt (A 36-37).**

The Trustee cross-moved for summary judgment (A 38-39).

United States District Judge Bauman, in an opinion dated January 8, 1974, denied Citibank's motion to dismiss,

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** The Fourth Cause of Action which did not involve an airplane lease was settled between the Trustee and Citibank and is not involved on this appeal.

and granted the Trustee's cross-motion for summary judgment, holding that the Trustee was entitled to recover from Citibank all payments received by it under the leases involved in the first three causes of action after the Chapter XI petition was filed on August 18, 1970, and referred the matter to a Magistrate to hear and report the amount of such payments (A 90) (368 F. Supp. 1333). Thereafter, Citibank and the Trustee stipulated as to the amounts of payments received by Citibank after August 18, 1970 (A 96-98), the Magistrate referred the stipulation to the District Judge as his report on the Trustee's damages (A 95) and the District Court thereafter entered its judgment on June 11, 1974 (A 99-101).

The Trustee had instituted a companion action against Chase Manhattan Bank, N.A. ("Chase"), and was likewise granted summary judgment (368 F. Supp. 1327). Chase appealed to this Court (Docket No. 74-1277). Since certain questions of law were common between the two cases, a stipulation was entered among the Trustee, Chase and Citibank consolidating the two appeals for purposes of argument only, and requiring that the Chase appeal follow the scheduling order of this Court dated June 28, 1974, with respect to the appeal of Citibank. On August 5, 1974, an order was entered by the Clerk and staff counsel to this Court approving of the consolidation of the two appeals for the purposes of argument only.

The Facts

The Chapter XI proceeding of the Bankrupt, which was commenced on August 18, 1970, terminated on October 16, 1970, when an order was entered in the Eastern District of New York adjudicating the Bankrupt as such (A 4). This action was commenced on April 18, 1973, over two years and six months from the date the Bankrupt was adjudicated on October 16, 1970 (A 2).

Prior to its bankruptcy, the Bankrupt had been engaged in the business of purchasing equipment and leasing the same to its customers (A 59).

On December 15, 1969, Citibank entered into a loan and security agreement with the Bankrupt for the purpose of assisting it in its business, by making loans to the Bankrupt, secured by an assignment of specific leases of property and a continuing security interest in the leased property and rentals therefrom (A 54, 58-74).

At all of the material times involved in this action the Bankrupt maintained its principal office in Queens County, New York.

On December 30 and December 31, 1969, Citibank filed UCC-1 financing statements against the Bankrupt with the Registrar of the City of New York, Queens County Division and the Secretary of State of the State of New York (A 54). Under these financing statements, the Bankrupt, as debtor, granted to Citibank, as secured party, a continuing security interest in leases and any and all rents due and to become due thereunder, including all related equipment described therein, chattel paper represented thereby, accounts receivable therewith, and the proceeds arising therefrom (A 75-76).

With respect to the three airplane leases involved in the First, Second and Third Causes of Action, on or about July 30, 1970, the Bankrupt assigned to Citibank a lease between it as lessor, and Vieques Air Link, Inc. ("Vieques"), as lessee, covering a Piper Cherokee aircraft, as partial collateral for advances which had been made by Citibank to the Bankrupt against another, but defaulted lease (A 54-55). On or about March 2, 1970, the Bankrupt assigned to Citibank a lease between itself as lessor, and James W. True ("True"), as lessee, covering another Piper Cherokee, for the same purpose as the Vieques lease (A 55). The third assigned lease was between the Bank-

rupt as lessor, and Raffa Van Atta Ltd. ("Raffa"), as lessee, covering a Beechcraft airplane, and was assigned to Citibank on or about December 29, 1969 (A 27), to secure a loan which Citibank made to the Bankrupt in the amount of $50,726.80 (A 56). The Vieques, True and Raffa leases were not recorded by the Bankrupt with the Administrator of the Federal Aviation Administration; nor were the assignments of these three leases recorded with the Administrator.

All of the three leases and the assignments thereof were physically delivered by the Bankrupt to Citibank (A 55).

In his statement submitted under Rule 9(g) of the General Rules of this Court, the Trustee contended that the rentals to be paid by Vieques, True and Raffa under the three leases were substantially equivalent to the value of the aircraft (A 41, 43-44). Citibank disclaimed knowledge as to such facts (A 56), and in its 9(g) statement, contended that whether the rentals to be paid under each of these three leases were substantially equivalent to the value of the leased aircraft was a relevant and material fact to be tried (A 79).

Although the Trustee's complaint did not specify whether his attack upon the validity of the assignments of the three airplane leases was premised under either Section 70(c) or 70(e)(1) of the Bankruptcy Act (the "Act"), or both, Citibank, in its memorandum of law in further support of its motion to dismiss and in opposition to the Trustee's cross-motion, contended that the Trustee's causes of action to invalidate the assignments of the airplane leases failed to state claims under Section 70(e)(1) of the Act, for the reason that the Trustee failed to allege the existence of an actual creditor with a provable claim at the time of the filing of the petition who could avoid the assignments of the leases (Record on Appeal, Document 10, pp. 14-15).

Judge Bauman treated the complaint as stating a claim under Section 70(c) of the Act (A 84-8), without specifically considering Citibank's attack upon the validity of the complaint in stating causes of action under Section 70(e)(1).

Questions Presented

1. Were the three claims of the Trustee under Section 70(c) of the Act to recover post-petition rentals received by Citibank under the assigned leases, time-barred by Section 11(e) of the Act, since this action was commenced more than two years from October 16, 1970, the date of adjudication?

2. Does Section 11(e) time-bar the trustee's claim under Section 70(c) to the aircraft leased by the bankrupt to Raffa Van Atta Ltd.?

3. Does the Federal Aviation Act govern the perfection of a security interest in rentals to be received by an owner of a leased aircraft?

4. Does the Federal Aviation Act require recordation of a lease of an aircraft, to perfect the security interest of Citibank in the leased aircraft itself, as against execution or attachment creditors of the Bankrupt-lessor.

POINT I

Each of the three causes of action was time-barred by Section 11(e) of the Bankruptcy Act.

The panoply of weapons granted to a trustee in bankruptcy under the Act to attack liens or security interests in personal property for failure of recordation is threefold.

First, the trustee may attack the unrecorded lien as a voidable preference under Section 60 of the Act. Section 60(a)(2) of the Act provides:

> ". . . a transfer of property other than real property shall be deemed to have been made or suffered at the time when it became so far perfected that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee . . . if any transfer of . . . property is not so perfected . . . it shall be deemed to have been made immediately before the filing of the petition."

Secondly, the trustee may attack the unrecorded lien under Section 70(c) of the Act if a judgment or attachment creditor could do so, whether or not such a creditor actually exists.

Lastly, the trustee may invalidate the unrecorded lien under Section 70(e)(1) of the Act, if any existing or actual creditor of the bankrupt, having a claim provable under the Act, could invalidate the unrecorded lien under any non-bankruptcy federal or state law.

Assuming, for the purposes of this discussion that assignments of airplane leases were required to be recorded with the Administrator under the Federal Aviation Act, there is no practical difference between an attack on the unrecorded lien under Section 60 or under Section 70(c) of the Act. If the assignments of leases were required to have been filed with the Administrator, and if unrecorded assignments are ineffective as against lien creditors of the Bankrupt-lessor, the assignments would be deemed to have been made immediately before the filing of the petition (Act, Section 60(a)(2)); while the trustee would be obliged to prove that the secured creditor had reasonable cause to believe that the bankrupt was insolvent immediately prior

to the petition date under Section 60(b), such proof would be automatic, if not conceded, by the secured creditor.

Although the trustee is not required to plead and prove knowledge of insolvency under Section 70(c), his right to invalidate the unrecorded assignments is measured by whether an attachment or execution creditor under the FAA could do so; in this respect, the trustee is granted the status of a hypothetical attachment or execution creditor by Section 70(c), and is not dependent upon the existence of an actual creditor having a provable claim under the Act, as he is under Section 70(e)(1).

Section 70(c) provides in material part, as follows:

> ". . . The trustee shall have as of the date of bankruptcy, the rights and power of: (1) a creditor who obtained a judgment against the bankrupt upon the date of bankruptcy, whether or not such a creditor exists, (2) a creditor who upon the date of bankruptcy obtained an execution returned unsatisfied against the bankrupt, whether or not such a creditor exists, and (3) a creditor who upon the date of bankruptcy obtained a lien by legal or equitable proceedings upon all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt upon a simple contract could have obtained such a lien, whether or not such a creditor exists. If a transfer is valid in part against creditors whose rights and powers are conferred upon the trustee under this subdivision, it shall be valid to a like extent against the trustee."

Section 11(e), which was added to the Bankruptcy Act by the Chandler Amendments of 1938, replaced former Section 11(d), and provides that:

> "e. A receiver or trustee may, within two years subsequent to the date of adjudication or within such further period of time as the Federal or State law may

permit, institute proceedings in behalf of the estate upon any claim against which the period of limitation fixed by Federal or State law had not expired at the time of the filing of the petition in bankruptcy. Where, by any agreement, a period of limitation is fixed for instituting a suit or proceeding upon any claim, or for presenting or filing any claim, proof of claim, proof of loss, demand, notice or the like, or where in any proceeding, judicial or otherwise, a period of limitation is fixed, either in such proceeding or by applicable Federal or State law, for taking any action, filing any claim or pleading, or doing any act, and where in any such case such period had not expired at the date of the filing of the petition in bankruptcy, the receiver or trustee of the bankrupt may, for the benefit of the estate, take any such action or do any such act, required of or permitted to the bankrupt, within a period of sixty days subsequent to the date of adjudication or within such further period as may be permitted by the agreement or in the proceeding or by applicable Federal or State law as the case may be."

Prior to 1938, Section 11(d) of the Bankruptcy Act of 1898 provided that:

> "Suits shall not be brought by or against a trustee of a bankrupt estate subsequent to two years after the estate has been closed."

In *Herget* v. *Central National Bank & Trust Co.*, 324 U.S. 4 (1945), Mr. Justice Murphy explained the historical reason for the replacement of Section 11d by the present Section 11(e):

> "State and lower federal courts explicitly and uniformly held that this two-year limitation controlled the trustee's right to set aside and recover preferential transfers under § 60 of the Act. But courts differed as to whether § 11d or state statutes of limitation ap-

> plied to causes of action inherited by the trustee from the bankrupt or the bankrupt's creditors.
>
> It was this conflict under § 11d of the 1898 Act that was primarily responsible for the framing of the new § 11e in 1938. This latter provision, which is controlling in this case, settles the problem by stating in part that 'A receiver or trustee may, within two years subsequent to the date of adjudication or within such further period of time as the federal or state law may permit, institute proceedings in behalf of the estate upon any claim against which the period of limitation fixed by federal or state law had not expired at the time of the filing of the petition in bankruptcy.' '' (324 U.S. at pp. 6-7)

Mr. Justice Murphy, speaking for a unanimous court, specifically held that Section 11(e) of the Act time-barred a preference action instituted more than two years from the date of adjudication in bankruptcy, and not the Illinois statute of limitations.

He noted that "Two-year limitations on suits by and against trustees have long been integral parts of federal bankruptcy statutes" (324 U.S. at p. 5), that ". . . Congress in § 11e failed to enlarge the time for bringing *suits arising under the Bankruptcy Act* by making state statutes of limitation of longer duration applicable to such federal causes of action" (324 U.S. at p. 7), that the "legislative background and history, as well as the language of § 11e, are barren of any basis for concluding that Congress intended to make suits of this nature subject to longer limitations imposed by state laws" (324 U.S. at p. 7) and, finally, that

> "Inasmuch as the federal Bankruptcy Act has created the liability and has also fixed the limitation of time for commencing actions to enforce it, we have no occasion to consider the trustee's arguments con-

cerning the applicability and construction of the Illinois statutes of limitation." (324 U.S. at p. 9)

As the Supreme Court pointed out in *Herget, supra,* it is only with respect to an *inherited* cause of action of a bankrupt that a trustee has a period greater than two years after adjudication to institute an action, if the Federal or State law governing the inherited cause of action had not expired at the time of the filing of the petition. For example, contract actions under New York law are governed by a six year statute of limitations, Civil Practice Law and Rules, Section 213(2). If, at the time the petition was filed, three years had expired from the time the cause of action accrued, the trustee would have three years, not two years, from the date of adjudication within which to bring such an action for breach of contract under Section 11(e). On the other hand, if at the time the petition was filed, five years had expired, the trustee would have two years, not one year, from the date of adjudication under Section 11(e) to institute such a suit.

However, if the cause of action is not an inherited cause of action but one which arises under the Bankruptcy Act, the trustee is limited in all instances to two years from the date of adjudication within which to commence an action. In the case at bar, the action asserted by the Trustee arises under Section 70(c) of the Act and is therefore governed by the specific period of two years from the date of adjudication as provided in Section 11(e). The Trustee's claim under Section 70(c) to avoid an unrecorded lien is based upon his Bankruptcy Act created status as a hypothetical lien creditor. The Trustee does not need to allege and prove the existence of an actual creditor of the Bankrupt at the time of the filing of the petition who could have avoided the unrecorded (under the FAA) security interest in the assigned lease rentals and the assigned rent producing chattel. While the Trustee must resort to another body of substantive law, here the FAA, to

determine if he, as a hypothetical lien creditor would prevail over the unrecorded assignments of the leases, his entry to this Court is Section 70(c) of the Act, the cause of action is not inherited from the estate but granted to the Trustee by the Act. Therefore, the cause of action must be governed by the two year limitation provided in Section 11(e). Recording statutes, whether the FAA or a conventional State recording statute relating to the filing of instruments affecting real property or personal property, do not provide periods of limitation. Such recording statutes only invalidate the unrecorded conveyance in favor of a class protected by the recording statute. Since the Trustee here is granted the specific status by the Bankruptcy Act of a hypothetical lien creditor with regard to personal property, his ability to assert a cause of action to invalidate an unrecorded security interest based upon that hypothetical status must be governed by the two year period contained in Section 11(e); otherwise, there is no period of repose and unsecured creditors who could not attack the unrecorded security interest will have obtained a windfall at the expense of the secured creditor.

The question as to whether Section 11(e) of the Bankruptcy Act applied to actions brought by a trustee under Section 70(c) is a question of first impression. Research has disclosed no case which specifically deals with this question of law. Two decisions bearing upon the issue as to the applicability of Section 11(e) to actions brought by a bankruptcy trustee under Section 70(e)(1) of the Act, are not dispositive of that issue, and do not provide any analogy to the 70(c) issue. In *Priebe* v. *Svehlek*, 245 F. Supp. 743 (D.C. Wisc., 1965), the District Court held that an action by a trustee under section 70(e)(1) to set aside a fraudulent conveyance under Wisconsin state law is governed by the Wisconsin statute of limitations. The fraudulent conveyance was made on or about February 15, 1961 and the bankruptcy was filed in March 1963. It is unclear from the reported decision when the action

was instituted by the trustee against the defendant, or whether the defendant was arguing the built-in limitations provision in Section 67(d) of the Act relative to fraudulent conveyances, which in general invalidates fraudulent conveyances taking place within one year prior to the filing of the petition, or the two-year statute of limitations contained in Section 11(e) relative to the time that the trustee must bring an action to set aside the fraudulent conveyance.

The other decision, *Buchman* v. *American Foam Rubber Corporation,* 250 F. Supp. 60 (SDNY, 1965) involved a counterclaim by a bankruptcy trustee to set aside certain payments made to the plaintiff by the bankrupt under a severance agreement as a fraudulent conveyance. The counterclaim was alleged to have arisen under Section 70(e) of the Act. The District Court (Irving Ben Cooper D.J.), correctly proceeded in its analysis of the question by pointing out that to succeed under Section 70(e), the trustee must establish an actual creditor having a provable claim under the Act who could have avoided the transfer (250 F.Supp. at pp. 65-66), saying

> ". . . Section 70, sub. e does not give a trustee rights of avoidance in addition to those possessed by a creditor; rather it places him in the creditor's legal shoes." (250 F. Supp. at p. 66)

The trustee sought to raise the rights of infant debenture holders, as the actual creditors who could avoid the transaction. The bankrupt was adjudicated as such on February 21, 1961 and the trustee's counterclaim was interposed on March 20, 1962, *within* the two-year period provided under Section 11(e). The precise question was whether the infant debenture holders, in whose shoes the trustee stood under Section 70(e), were time barred under state law from having attacked the alleged fraudulent conveyance, prior to the bankruptcy. The District Court held that the trustee was able to avail himself of the same

tolling provisions afforded to infants under state law, as would have been available to the infants, to toll the applicable state statute of limitations; since the infant debenture holders were not time-barred *prior* to bankruptcy by reason of the tolling of the statute, neither was the trustee. The court said that with respect to actions under Section 70(e)(1), the trustee was

> "Subject to the same defense as the creditor in whose shoes he stands, the trustee is entitled to assert fully the rights of that creditor. Recognition of that principle here contravenes no state interest and comports with the remedial purpose of the Bankruptcy Act." (250 F. Supp. at p. 72)

Based upon the foregoing analysis of the *Priebe* and *Buchman* cases, *supra,* each of those cases did not involve the precise issue as to whether Section 11(e) would apply to a claim asserted by a trustee under Section 70(e)(1), if the trustee asserted that 70(e)(1) claim *more* than two years from the date of adjudication. Neither of those cases, therefore, can be cited as having any bearing by analogy to the question as to whether Section 11(e) applies to a suit brought by a bankruptcy trustee under Section 70(c) of the Act. Whatever may be the proper application of Section 11(e) of the Act to a claim asserted by a trustee under Section 70(e)(1), it is at least clear that the trustee's standing under Section 70(e) is based upon the rights of an *actual* creditor of the bankrupt to whose rights the trustee is subrogated at the time of the filing of the petition. Under Section 70(c), the trustee is federally granted the status of a hypothetical lien creditor by reason of that section of the Bankruptcy Act, and he is not dependent upon *inherited* rights of an actual creditor at the time of the filing of the petition. His cause of action under 70(c) is not derivative from the rights of an actual creditor, but is granted by the Bankruptcy Act itself. Therefore, the limitations provision

of Section 11(e) should apply with equal force to an action under Section 70(c) as it does to an action under Section 60 and under Section 67(a),* where the trustee's rights are created by the Bankruptcy Act. While no case authority exists concerning the applicability of Section 11(e) of an action instituted by a bankruptcy trustee, under the *Federal* Fraudulent Conveyance Act contained in Section 67(d) we do not believe it could be questioned that Section 11(e) would be applicable to such fraudulent conveyance actions since the right to avoid the fraudulent conveyance is created by the Bankruptcy Act. Parallel reasoning would, therefore, compel the conclusion that Section 11(e) should apply to actions under Section 70(c), as it does to actions under Section 60 and 67(a), and as it would undoubtedly apply to actions under 67(d). In all of these instances, the trustee's right to sue is created by the Act, and is not derived from the rights of actual creditors. Therefore his right to sue should be measured by the two-year limitations provision in Section 11(e).

The District Court below admitted that:

> "The trustee's suit appears to have been brought under section 70(c) . . ." (A 84-85)

However, the error of the District Court in refusing to apply the two-year limitations statute of Section 11(e) to this Bankruptcy Act created cause of action resulted from confusing the statute which created the cause of action, i.e. the Act, with the statute which measures the extent of the Trustee's rights as a hypothetical lien creditor, here the FAA.

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* A suit under Section 70(c) is as much a bankruptcy created right of action and hence governed by the two-year statute of limitations provided in Section 11(e), as an action to set aside a judicial lien obtained within four months of the filing of a bankruptcy petition, by reason of Section 67(a)(1) of the Act. *See Samuels* v. *Kockos Bros. Ltd.*, 307 F. 2d, 147 (9th Cir., 1962).

Subject matter jurisdiction over the Trustee's action is not conferred by the Federal Aviation Act of 1958, or by 12 U.S.C. § 94. The latter statute is merely a venue statute with respect to suits against national banks and the Federal Aviation Act does not create a federal cause of action in favor of a bankruptcy trustee.

Section 70(c) of the Act is the only statute which can be relied upon by the trustee to create a cause of action in his favor and hence, this suit arises under the Act. If applicable at all, the FAA merely determines the extent of the rights of the Trustee, as a hypothetical execution or attachment creditor of the Bankrupt, to an unrecorded assignment of a lease of an airplane. But it is Section 70(c) of the Act which creates the Trustee's cause of action. One must be a bankruptcy trustee and invoke Section 70(c) of the Act, to attain the status of a hypothetical execution or attachment creditor, before the transaction can be measured by the FAA.

The Trustee cannot rely under Section 70(c) upon inherited rights of an actual creditor. *Lewis* v. *Manufacturers National Bank of Detroit,* 364 U.S. 603 (1960). There, Mr. Justice Douglas, speaking for a unanimous court, held that a bankruptcy trustee may not rely upon Section 70(c) to set aside a lien recorded prior to the filing of the petition, but allegedly invalid under state law by reason of late filing. As Justice Douglas pointed out, to permit the trustee to use Section 70(c) in his status as a hypothetical lien creditor to invalidate a pre-petition recorded lien ". . . which no creditor could void and which injured no creditor . . . would enrich unsecured creditors at the expense of secured creditors, creating a windfall merely by reason of the happenstance of bankruptcy." (364 U.S. at pp. 608-609).

Justice Douglas then continued:

> "It is true that in some instances the trustee has rights which existing creditors may not have. Section

11, 11 U.S.C. § 29, gives him two years to institute legal proceedings regardless of what limitations creditors might have been under. Section 60, 11 U.S.C. § 96, gives him the right to recover preferential transfers made by the bankrupt within four months whether or not creditors had that right by local law. A like power exists under § 67a, 11 U.S.C. § 107(a), as respects the invalidation of judicial liens obtained within four months of bankruptcy when the bankrupt was insolvent. Section 67d, 11 U.S.C. § 107(d), carefully defines transactions which may be voided if made 'within one year prior to the filing' of the petition.

Congress in striking a balance between secured and unsecured creditors has provided for specific periods of repose beyond which transactions of the bankrupt prior to bankruptcy may no longer be upset—except and unless existing creditors can set them aside. Yet if we construe § 70c as petitioner does, there would be no period of repose. Security transactions entered into in good faith years before the bankruptcy could be upset if the trustee were ingenious enough to conjure up a hypothetical situation in which a hypothetical creditor might have had such a right."

The refusal by the Court in *Lewis* v. *Manufacturers National Bank of Detroit, supra,* to permit a bankrupt trustee to assert his right as a hypothetical lien creditor to attack a pre-petition recorded lien, where no existing creditor was shown to be able to do so, should likewise be extended by parallel reasoning to prohibit a cause of action based upon Section 70(c) and the hypothetical lien creditor status granted thereunder, from being asserted more than two years from the date of adjudication, when no actual creditor exists who could have done so.

Section 11(e) of the Act, as Justice Douglas noted, has provided a specific period of repose beyond which transactions of the bankrupt prior to bankruptcy may no longer

be upset, except and unless existing creditors could set them aside.

Finally, the nature of statutes of limitations comports with the application of Section 11(e) to a trustee's claim under Section 70(c).

In *Bell* v. *Morrison,* 26 U.S. 351 (1828), Mr. Justice Story stated:

> ". . . it has often been a matter of regret, . . . that, in the construction of the statute of limitations, the decisions had not proceeded upon principles better adapted to carry into effect the real objects of the statute; that instead of being viewed in an unfavorable light, . . . it had received such support as would have made it what it was intended to be, emphatically, a statute of repose." (26 U.S. at p. 360)

In *McCluny* v. *Silliman,* 28 U.S. 270 (1830), Mr. Justice McLean said (at p. 277):

> "The courts do not now, unless compelled by the force of former decisions, give a strained construction, to evade the effect of those [limitations] statutes . . ."

In *United States* v. *Oregon Lumber Co.,* 260 U.S. 290 (1922) Mr. Justice Sutherland stated that a statute of limitations is

> ". . . not a technical defense but substantial and meritorious. The great weight of modern authority is to this effect."

In *Guaranty Trust Co. of New York* v. *United States,* 304 U.S. 126 (1938), Mr. Justice Stone said (at p. 136)

> "The statute of limitations is a statute of repose . . . regarded by this Court . . . as a meritorious defense, in itself serving a public interest."

Mr. Justice Jackson in *Chase Securities Co.* v. *Donaldson,* 325 U.S. 304 (1945) said of statutes of limitations that:

> ". . . They have come into the law not through the judicial process but through legislation. They represent a public policy about the privilege to litigate. . . . the history of pleas of limitations shows them to be good only by legislative grace and to be subject to a relatively large degree of legislative control." (325 U.S. at p. 314)

And, as Mr. Justice Douglas said with specific reference to Section 11(e) in *Lewis* v. *Manufacturers National Bank of Detroit, supra,*

> "Congress in striking a balance between secured and unsecured creditors has provided for specific periods of repose beyond which transactions of the bankruptcy prior to bankruptcy may no longer be upset—except and unless existing creditors can set them aside. Yet if we construe § 70c as petitioner does, there would be no period of repose." (634 U.S. at p. 609)

The District Court, by strained and erroneous judicial construction, where no prior precedent existed, has negated the policy and purpose of Section 11(e) in specific, and statutes of limitation in general, by refusing to apply the two year limitations provision of Section 11(e) to the Trustee's 70(c) claims for post-petition rentals received by Citibank, as well as to the airplane covered by the Raffa Van Atta Ltd. lease.

POINT II

Citibank was not required to record the assignments of the three airplane leases under the Federal Aviation Act in order to have priority with regard to the lease rentals over an execution or attachment creditor of the Bankrupt lessor.

In this Point II, we merely summarize the argument that the Federal Aviation Act does not require the assignment of aircraft leases in order to perfect a security interest in the assigned rents. This has been ably and exhaustively discussed by counsel for Chase Manhattan Bank, N.A. (Docket No. 74-1277) in their appellant's brief and appellant's reply brief. No useful purpose would be served by setting forth in full the arguments raised by counsel for Chase with respect to this common issue on which Citibank and Chase are ranged on the same side as against the Trustee. We acted as counsel to Citibank in connection with the appeal by Citibank to this Court in *In re Leasing Consultants, Incorporated,* 486 F.2d 367 (2d Cir. 1973), in which this Court recognized the separate security interests in assigned lease rentals and in the rent producing leased chattel. This Court concluded that the security interest in the rents involved different Code requirements for perfection than did the perfection of a security interest in the assigned rent producing chattel.

Section 503(a) of the FAA (49 U.S.C. § 1403 (a)(1)) provides:

> "The Administrator shall establish and maintain a system for the recording of each and all of the following:
>
> "Any conveyance which affects the title to, or any interest in, any civil aircraft of the United States;"

Section 503(c) of the FAA (49 U.S.C. § 1403(c) provides:

> "No conveyance or instrument the recording of which is provided for by subsection (a) of this section shall be valid in respect of such aircraft . . . against any person other than the person by whom the conveyance or other instrument is made or given, his heir or devisee, or any person having actual notice thereof, until such conveyance or other instrument is filed for recordation in the office of the Administrator: . . ."

Each of the first three causes of action sought to recover post-petition rentals paid by the lessees of the various aircraft to Citibank, and rentals remaining to be paid.

The assignment to Citibank of the lease rentals is not a

> ". . . conveyance which affects the title to, or any interest in, any civil aircraft of the United States;".

Section 9-104(a) of the New York Code which provides as follows, continues to govern perfection requirements to the lease rentals.

> "This article does not apply
>
> (a) to a security interest subject to any statute of the United States such as the Ship Mortgage Act, 1920, to the extent that such statute governs the rights of parties to and third parties affected by transactions in particular types of property;".

In approaching this exception to the application of the Code with respect to security interests subject to federal filing systems, it is important to note, as one leading commentator has observed, that the federal filing statutes are interstitial only, and that:

> "Section 9-104 excludes from the scope of article 9 security interests subject to such a federal statute 'to

> the extent that such statute governs the rights of parties to and third parties affected by transactions in particular types of property'. To put the matter the other way around article 9 does apply to the extent that the federal statute does not contain its own substantive provisions." *1 Gilmore, Security Interests in Personal Property*", p. 543.

Furthermore the FAA was designed to provide an exclusive recording or filing system with respect to instruments of title affecting the aircraft itself, or mortgages or like security documents similarly affecting the aircraft itself, and to protect subsequent good faith purchasers and mortgagees from the effect of unrecorded instruments, not execution or attachment creditors of the owner of the aircraft. See Point III, *infra.*

As stated in *Southern Jersey Airways, Inc.* v. *National Bank of Secaucus,* 108 N.J. Super. 369, 261 A 2d 399, 403:

> "Thorough study of the matter convinces us that Congress did not intend by adoption of the cited recordation procedure necessarily to displace and preempt all state law otherwise applicable bearing upon priorities of lien and title interests in aircraft. Rather was it the intent, in relation to aircraft, to substitute for the multiplicity of state registration or recording systems a single preemptive federal system for registering *(1) instruments of title, comparable to state registration of titles to motor vehicles, and recording (2) security documents of the kinds commonly comprehended by state recording laws concerning written consensual security interests affecting personal property.* The reason was that the ready mobility of aircraft and their common use across state lines made it cumbersome and burdensome for persons having concern with title to or incumbrances on aircraft to have to record or search in all states or localities which could arguably be

claimed to constitute the proper recording situs in relation to the specific owner or incumbrancer of a particular aircraft. See Scott, "Liens in Aircraft: Priorities" 25 J.Air L. & Com. 193, 200, 203 (1958); Case Note 48 Colum.L.Rev. 1248 (1948). *Thus, failure to federally record a recordable instrument would entail the specific consequences declared by § 1403(c), but no other.* Federal recording would validate a title or incumbrance as against any claim of invalidity based upon absence of state recording, but would not necessarily create affirmative priority as against competing rights declared by applicable state law." (Emphasis added)

The failure to record a security agreement or a lease or assignments thereof is governed by the FAA only to the extent that such instruments affect the title to the aircraft itself; the Uniform Commercial Code governs the perfection of security interests in the rents enjoyed by the owner of that leased aircraft.

Moreover, as explained in Point III, *infra,* the Trustee as an execution or attachment creditor of the lessor is not a member of the class protected by the FAA from unrecorded interests, only bona fide purchasers or mortgagees.

In the case at bar, Citibank clearly perfected a security interest under the *New York Code* in the *rents.* It filed financing statements with both the Secretary of State of New York and the Register of the City of New York, Queens County Division (the County where the Bankrupt had its principal place of business), pursuant to which Citibank was granted:

> "Continuing security interest in leases and any and all rents due and to become due thereunder . . ."

and also had actual possession of the assigned leases.*

Each of the three assignments of the aircraft leases, copies of which were attached both to the complaint (A 19, 27, 35) and to Mr. Kollander's affidavit (A 77) assigned to Citibank all of the Bankrupt's rights in all monies due or to become due under the leases.

That New York was the proper place to perfect a security interest in the assigned rents under the Code is unquestionable. The Bankrupt's principal office was in New York, the loan and security agreement provided that New York law governed the relationships between Citibank and the Bankrupt (A 72, ¶ XX), and each of the three aircraft leases attached to the complaint provide that they were to be governed by New York law (A 13, sec. 18; A 21, sec. 18; A 30, sec. 21).

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* All of the assigned leases were "chattel paper" under the Code, regardless whether they were disguised security agreements or "true" leases. See, e.g. *New York Code,* 9-105(1)(b) and Official Comments 3 and 4 thereto.

Security interests in chattel paper may be perfected by filing. *New York Code* 9-304(1), or by the secured party's taking possession of the chattel paper. *New York Code* 9-305. See also the rights of a purchaser in possession of the chattel paper as against prior security interests therein. *New York Code,* 9-308.

The default of the Bankrupt gives Citibank the right to receive and retain the rents from the lessees, regardless whether the loan and security agreement or the specific assignments so provided. *New York Code,* 9-502.

POINT III

To the extent that the Trustee sought a judgment declaring that Citibank's interest in the three airplane leases was inferior to his rights under Section 70(c) of the Act, the causes of action failed to state claims, since Citibank was not required under the Federal Aviation Act to file the assignments of the leases in order to have superior rights to the aircraft as against attachment or execution creditors of the Bankrupt. Since Citibank properly perfected its liens upon the chattel paper under the New York Code, it perfected its security interest to the Bankrupt's rights in the aircraft.

In *1 Gilmore on Security Interests in Personal Property,* Section 503 of the FAA (49 U.S.C. § 1403) is explained as follows:

> "Except for the engine and spare parts liens, § 503 is not in any sense a substantive statute. Therefore, it is believed, apart from these substantive provisions, the question of formal requisites, and the operation of the recording system, state law should apply to determine any question arising in connection with a security interest in aircraft. The argument for a federal law solution is even weaker here than under any of the other federal statutes we have so far discussed: § 503 is much less comprehensive than the Ship Mortgage Act and there is not the same federal source of power that could be alleged in favor of a federal solution in the fields of copyright, patent and admiralty law. The cases decided under § 503 all seem to assume that state law is generally applicable and that § 503 is clearly an 'interstitial' statute, which goes as far as it goes but no further." (1 Gilmore, at p. 426)

There is nothing either in Section 503 or in the definitions contained in Section 501 (especially 501(16) and (17)), or in the regulations issued by the Federal Aviation Administrator, which requires the recordation of the assignment of a lease by an owner-lessor to an assignee.

Section 503(a)(1) has been construed to require the recording of conveyances *only* as against subsequent bona fide purchasers or mortgagees or others holding a contractual security interest in the aircraft itself, without notice of the prior interest. *Southern Jersey Airways, Inc.* v. *National Bank of Secaucus, supra,* pp. 403-404; *Marrs* v. *Barbeau,* —— Mass. ——, 146 N.E. 2d 353 (1957); *Marshall* v. *Bardin,* 169 Kan. 534, 220 P 2d 187 (1950).

The New York Real Property Law ("RPL") Section 290 et seq. also provides a fitting analogy to the construction of the recording provision of the FAA in limiting the protected class to bona fide purchasers for value and without notice, or bona fide *contract* lienors (i.e., mortgagees) for value and without notice, and not execution or attachment creditors of the owner of the aircraft. Section 291 of the RPL requires the recordation of a "conveyance" of real property. Section 1403(a) of Title 49, U.S.C., requires the Administrator to establish and maintain a system for the recordation of any "conveyance" which affects title to a civil aircraft. RPL Section 291 further provides that every conveyance not so recorded is void as against ". . . any person . . ." who subsequently purchases or acquires by exchange or contracts to purchase or acquire by exchange, the same real property, in good faith and for a valuable consideration from the same owner. "Purchaser" is defined by RPL Section 290(2) to include every person to whom any estate or interest in real property is conveyed for a valuable consideration. Section 1403(c) of Title 49, U.S.C., similarly provides that an unrecorded conveyance of an aircraft is invalid against "any person" other than the party who executed the conveyance.

It has long been held that the recording provisions of the RPL do not protect judgment creditors of the owner but only subsequent purchasers and mortgagees, from the effect of unrecorded conveyances. The theory is that the judgment lien only attaches to the judgment debtor's actual interest in the real property sought to be subjected to payment of the judgment, and that the title of the judgment debtor's grantee under a conveyance predating the judgment has precedence over the judgment lien, even though the deed was not recorded. See, for example, *Suffolk County Federal Savings and Loan Association* v. *Geiger*, 57 Misc.2d 184 (1968).

The Trustee, in the case at bar, is not granted the status of a hypothetical bona fide purchaser for value, or hypothetical mortgagee, under Section 70(c). He has only the status of a hypothetical judgment lien or attachment creditor. The recording provisions of the FAA are only concerned with protection of subsequent grantees or mortgagees of the aircraft from the effect of an unrecorded conveyance. The statute was not intended to protect judgment creditors of the owner from the effect of unrecorded conveyances, since judgment creditors can only reach the *actual* interest of the owner in the aircraft at the time the judgment lien was obtained. In the case at bar, the unrecorded (under the FAA) assignments of the leases of the aircraft was conveyed to Citibank prior to the date the Bankrupt herein filed its petition under Chapter 11 and consequently, prior to the time the Trustee, as a hypothetical judgment or attachment creditor under Section 70(c), obtained his hypothetical lien.

As noted with respect to Point II, *supra*, Citibank perfected a security interest in the leases and in the rentals under the New York Uniform Commercial Code, which would entitle Citibank to prevail over the Trustee in his capacity as a hypothetical execution or attachment creditor.

CONCLUSION

For the reasons set forth above, the judgment appealed from should be reversed on the law and the Trustee's action dismissed in all respects.

Respectfully submitted,

ZALKIN, RODIN & GOODMAN
Attorneys for Defendant-Appellant
First National City Bank

HENRY LEWIS GOODMAN
Of Counsel

Due and timely service of TWO copies
of the within BRIEF is hereby
admitted this 3rd day of SEPTEMBER 1974.

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Attorneys for APPELLEE